

1 **DIRECT TESTIMONY**

2 **OF**

3 **JOSEPH C. BOUKNIGHT**

4 **ON BEHALF OF**

5 **SOUTH CAROLINA ELECTRIC & GAS COMPANY**

6 **DOCKET NO. 2005-113-G**

7 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION**
8 **WITH SOUTH CAROLINA ELECTRIC & GAS COMPANY.**

9 **A.** Joseph C. Bouknight, 1426 Main Street, Columbia, South Carolina. My position
10 is Senior Vice President, Human Resources, of SCANA Corporation and South
11 Carolina Electric & Gas Company ("SCE&G," or the "Company").

12 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
13 **PROFESSIONAL EXPERIENCE.**

14 **A.** I am a graduate of the University of South Carolina with a B.S. Degree in Biology.
15 I began my career in human resources at Sonoco Products Company in June 1976
16 as a Compensation and Benefits Analyst. At Sonoco, I served as Training
17 Manager, Regional Employee Relations Manager, Director of Employee Relations
18 and EEO/AA, Director of International HR and Division Vice President HR. I left
19 Sonoco in 1999 to become Vice President Human Resources, for Dan River Inc. I
20 joined SCANA in April of 2004 as Senior Vice President of Human Resources.
21 My job entails responsibility for all aspects of human resources at SCANA,
22 including SCE&G and SCANA's other subsidiaries, including responsibility for

1 compensation plans, health care plans, incentive or at-risk pay plans, and
2 recruitment and retention of employees.

3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

4 **A.** The purpose of my testimony is to provide an overview of the new approaches
5 SCANA and SCE&G are taking to control health care costs, which is one of the
6 most rapidly growing costs in American business today. I will also discuss
7 SCE&G's employee incentive plans as a part of our overall compensation package
8 and explain the role that these plans play in the competition that we face in
9 attracting and retaining skilled personnel to operate and manage our utility
10 systems.

11 **Q. PLEASE DESCRIBE SCANA'S EXPERIENCE WITH HEALTH CARE**
12 **COSTS.**

13 **A.** Like most businesses of its kind, SCE&G offers a reasonably comprehensive
14 package of health care benefits. Providing health care is an important part of our
15 employee compensation package and is critical for recruitment and retention. In
16 past years, SCANA has taken steps to mitigate rising health care costs by
17 increasing employee contributions, raising deductibles and increasing co-pays.
18 Nonetheless, in recent years we have seen significant increases in SCE&G's and
19 SCANA's health costs.

20 SCANA and SCE&G, by the way, are self-insured insofar as health care
21 costs are concerned. CIGNA Corporation processes claims and handles other
22 administrative aspects of the health care program under contract with SCANA.

1 But for reasons of economy, the costs of the program and of claims under it are
2 paid by SCANA rather than being born by an independent insurer.

3 **Q. WHAT APPROACH HAVE YOU TAKEN TO CONTROLLING HEALTH**
4 **CARE COSTS?**

5 A. Our initial approach to controlling health care costs has been to work with our
6 vendors, specifically CIGNA, to mitigate costs. We have also taken steps to
7 provide heightened care management for employees on short term-disability leave.
8 The results of this initiative so far have been encouraging. SCANA's health care
9 costs increased by only 1% from 2003 to 2004, compared to 18% the year before.
10 However, I should state that there is natural variability in health care costs year to
11 year, and these beneficial trends could change if there were a future increase in the
12 number or severity of major medical claims.

13 The Company is taking steps to mitigate the increase in health care costs by
14 addressing the factors that drive medical claims. This is a long-term strategy that
15 we think will pay significant dividends in future years.

16 **Q. PLEASE EXPLAIN.**

17 A. SCANA has recently adopted a series of measures to slow the rate of growth in
18 health care costs by addressing a principal driver of those costs, i.e., the health of
19 our workforce and their dependents. Having reviewed the data, it is clear to us
20 that the greatest opportunity we have as a Company to control health care costs is
21 in helping participants improve their lifestyles which will result both in reduced
22 health care costs and in improved employee productivity.

1 Let me explain why lifestyle related health is so important. There are at
2 present some 15,000 employees, dependents and retirees who are covered under
3 SCANA's health care plan. Based on demographics, we know that a majority of
4 these people, over 69% of the total group, are healthy today with low to moderate
5 future health risks. These individuals generate average per capita health care
6 claims of less than \$1,000 per year. Although they represent a majority of people
7 receiving health care coverage from SCANA, they represent only 7% of the
8 annual cost of health care SCANA-wide.

9 On the other hand, the majority of the Company's health care costs are
10 generated by a very small portion of the plan participants. Specifically, at
11 SCANA today, less than 4% of the plan participants generates 70% of the health
12 care costs. This group includes many people with chronic health problems –
13 chronic heart disease, diabetes and musculoskeletal problems (such as back and
14 joint problems) – that create substantial costs long term. These people need and
15 deserve quality medical care, and SCANA is committed to providing it to them.

16 But at the same time, we understand that real health care savings long-term
17 depend on limiting the number of people who fall into this 4% group in the future.
18 We estimate that about one third of our employees are relatively healthy today but
19 are at-risk for future chronic health problems due to lifestyle and other causes.
20 With time, unless lifestyle changes are made, a significant portion of this group
21 will develop chronic health problems. Our goal is to prevent that migration from
22 happening to the greatest degree possible.

1 We are doing so by making comprehensive health and wellness counseling
2 available to the employees, retirees and dependents covered by our plan. We are
3 asking everyone to consider where they are today in terms of lifestyle and
4 understand how that can affect their future health. By educating and encouraging
5 them to take advantage of these resources they can begin to make changes,
6 however modest, that can improve their prospects for health long-term. All this is
7 part of our effort to make wellness a key and highly visible corporate goal.

8 **Q. ARE THE HEALTH CARE COST STATISTICS FOR SCANA UNUSUAL**
9 **IN THE CONCENTRATION OF CLAIMS WITHIN A SMALL GROUP OF**
10 **PLAN PARTICIPANTS?**

11 A. No, they are not. While the statistics listed above may seem surprising, chronic
12 illnesses is a major driver of health care costs for most companies, and a relatively
13 small group of plan participants are typically responsible for the majority of health
14 care costs. The statistics for SCANA are not unusual in this respect.

15 **Q. WHAT SPECIFICALLY ARE YOU DOING TO PROMOTE SCANA'S**
16 **WELLNESS INITIATIVE?**

17 A. The first and most visible thing we have done is to set up a voluntary in-house
18 pharmacy in the new LiveWell Resource Center™ at the Palmetto Center. In
19 2004, our plan participants filled over 247,000 prescriptions. We are concerned
20 that, in spite of the best intentions of all involved, individuals under our plan may
21 be receiving inconsistent counseling regarding the overall effectiveness of these

1 prescriptions on their health and well-being, the side effects, and possible adverse
2 interactions.

3 The new pharmacy is being staffed by a licensed pharmacist who will be
4 on duty both to fill prescriptions and to answer health related questions from
5 covered individuals. He can provide individual review of medication usage,
6 confidential one-on-one employee counseling on drug interactions, and, if
7 authorized, personal and confidential discussions with treating physicians to
8 ensure appropriate pharmacotherapy.

9 Our pharmacy can provide "next day" delivery of medications to most
10 work locations using internal mail. We have authorization from the South
11 Carolina Board of Pharmacy to provide this service. In addition, our pharmacist
12 will travel regularly throughout our service area to meet face to face with plan
13 participants. In effect, our employees and their dependents will have a dedicated
14 advisor to counsel them on the health aspects of their prescription medications.
15 We expect our savings on drug costs to offset the fixed expenses of having our
16 own pharmacy and pharmacist.

17 **Q. WHAT ARE THE OTHER ASPECTS OF YOUR INITIATIVE?**

18 A. This is only one aspect of the proposed initiative. The gateway to our larger
19 wellness program is our HealthSmart web-site, which contains a Health Risk
20 Assessment program. When employees or other plan participants take the
21 assessment, the results are provided to a health coach, who consults individually
22 with each employee to review the results. The health coaches are trained in setting

1 reasonable and achievable health improvement goals, and in creating individually
2 tailored fitness, nutrition and wellness plans. After the initial consultation,
3 coaches are available to follow up with employees by phone over an extended
4 period of time to encourage them to stick to their goals or reformulate them if
5 needed.

6 A health coach will also be located in the LiveWell Resource Center™
7 next to and working closely with the company pharmacist. In addition, our
8 behavioral health professionals will be located at the center so that immediate,
9 confidential referrals can be made if either a discussion with the pharmacist or
10 consultation with a health coach indicates that a behavioral health consultation
11 would be helpful. The relationship between behavioral health issues, particularly
12 stress and depression, and overall health is well documented. By creating a
13 partnership between our pharmacist, our health coach and our behavioral health
14 consultants, we will be able to bring all our wellness resources together to
15 encourage the people in our covered group to improve their health and wellness.
16 The key part of the plan will be the availability and access to our wellness
17 professionals.

18 **Q. WHERE DO YOU STAND IN IMPLEMENTING THIS INITIATIVE?**

19 A. In July of 2004, our senior leadership identified wellness as a key corporate goal
20 and we began communication with the individuals covered by our plan. As of late
21 May 2005, our pharmacist has been hired and we have hired an outside contractor
22 to provide our health coaches. The LiveWell Resource Center™ will be

1 completed in July of 2005 and will go into operation then. We have been in
2 regular communication with our employees and other covered individuals about
3 this initiative and the benefits a healthier lifestyle can provide to them.

4 In summary, we believe this wellness initiative will help our employees live
5 healthier lives and mitigate the rising cost of healthcare for the Company.

6 **COMPENSATION**

7 **Q. WHAT ARE SCE&G'S GOALS IN SETTING PAY LEVELS?**

8 A As a utility company serving 282,000 natural gas customers and over 585,000
9 electric customers, SCE&G must recruit, hire and retain a large number of
10 technically skilled individuals. In doing so, SCE&G competes in several different
11 labor markets. For most hourly jobs, the labor market is local. For most salaried
12 jobs, the market is primarily regional. In other cases, the relevant markets are
13 national.

14 Whatever the market, SCE&G must offer a competitive package to attract
15 new employees and to retain existing employees. SCE&G can and does lose
16 highly valued and highly skilled employees to other employers, and when that
17 happens, we lose the value of training and experience that these employees
18 possess.

1 **Q. PLEASE EXPLAIN SCE&G'S PHILOSOPHY FOR SETTING ITS LEVELS OF**
2 **COMPENSATION.**

3 A. SCE&G has a philosophy of paying based on market data and setting the
4 benchmark compensation at the mid-point of the relevant market range. Our
5 compensation package is consistent with that standard.

6 **Q. HOW DO YOU DETERMINE THAT RANGE?**

7 A. SCE&G participates in or receives information from a number of salary surveys
8 by industry groups like the Southern Gas Association and the Edison Electric
9 Institute, and by compensation consulting groups like Hewitt and Associates,
10 Mercer Human Resource Consulting LLC, and Watson Wyatt Worldwide. These
11 surveys provide market data concerning actual compensation being paid for
12 hundreds of key positions in the regional or national markets. In some cases, the
13 data are specific to jobs in the natural gas or utility industry. In other cases, the
14 data are more general and concern pay for positions that exist in both utility and
15 non-utility businesses. The data are typically organized to show quartiles and
16 mid-points of compensation ranges for national or regional markets. Our HR
17 department collects and reviews the market information for hourly jobs in local
18 markets like Columbia and Charleston. In addition to survey data, Hewitt and
19 Associates uses proprietary data to specifically benchmark our officer level jobs to
20 the market.

1 **Q. HOW DO YOU USE THE DATA FROM NATIONAL AND REGIONAL**
2 **MARKETS TO DETERMINE COMPENSATION LEVELS FOR JOBS**
3 **WITHIN SCE&G?**

4 A Overall, we benchmark 300 individual SCANA positions to the market. These
5 300 positions represent about 2,000 salaried employees or 59% of the total
6 salaried workforce at SCANA. Those 300 positions then become the points of
7 reference around which we slot the other jobs in SCE&G and SCANA. That
8 slotting is done based on the relative skills or experience required by the job and
9 overall comparability of the individual job to other jobs on the list. Once the
10 slotting is done, we determine the market rate for the job based on the mid-point
11 of the relevant market. In other words, we do not pay a premium over the market,
12 but pay at the rate that puts us in the midpoint or middle of what the market pays.

13 **AT-RISK COMPENSATION**

14 **Q. WHY DOES SCE&G PROVIDE AT-RISK COMPENSATION?**

15 A. Once we determine the market compensation for a position, we structure part of
16 that compensation as base salary and part as variable or at-risk pay. All our
17 employees have some portion of their pay at-risk, that is based on achievement of
18 certain pre-established annual goals. At-risk compensation plans have been a part
19 of SCE&G's approach to motivating job performance for over a decade. I believe
20 that much of the credit for our Company's success in operating its utility systems
21 efficiently is due to at-risk pay and its effect in motivating and focusing employees
22 to achieve individual and business goals. Our employees are in fact very

1 committed to achieving individual and business goals. Thus, a primary reason for
2 having at-risk pay is to ensure the continued performance and success of our
3 Company.

4 Another reason we have at-risk pay is to attract and retain good employees
5 The standard packages offered by the sorts of companies with which SCE&G
6 competes for employees include significant at-risk compensation. Applicants
7 expect at-risk compensation to be part of the compensation they will be offered by
8 SCE&G, much as they expect health care and paid vacation. Not to have an at-
9 risk compensation program would put SCE&G at a significant disadvantage in
10 recruiting and retaining employees. It would be damaging to the company's long-
11 term ability to attract and retain the kind of skilled and motivated employees that
12 are required to safely, reliably and efficiently operate its utility system. As
13 mentioned above, SCE&G offers compensation packages that are at the mid-point
14 of the market. At-risk incentive plans are an important part of those overall
15 compensation packages. To eliminate at-risk compensation would negatively
16 impact how SCE&G's overall compensation plans fit with the market.

17 **Q. HOW WOULD YOU COMPARE SCE&G'S AT-RISK COMPENSATION**
18 **PLAN TO A BONUS PLAN?**

19 A. A bonus plan is generally understood in the industry as a business voluntarily
20 making payments to employees that are over and above basic compensation when
21 the business's finances support doing so. At-risk compensation, on the other hand,
22 involves making a part of the employee's basic compensation package conditional

1 on achieving certain goals. In the case of SCE&G, we have a market based
2 compensation plan in total, but part of that market based compensation is at-risk.
3 Employees and the business as a whole must earn that part of the compensation
4 package year by year. Employees are paid for performance, and only when goals
5 are met do employees earn their full compensation package.

6 **Q. DO YOU BELIEVE THAT SCE&G'S AT-RISK COMPENSATION**
7 **REALLY DOES IMPACT EMPLOYEE PRODUCTIVITY AND**
8 **PERFORMANCE?**

9 A. Yes. At-risk compensation is uniquely effective in communicating to employees
10 the link between their performance and their pay. All companies that are trying to
11 improve efficiency and performance face the question of how to get employees,
12 managers and officers to adopt the business's goals of efficiency and performance
13 as the employees' personal goals for their job. A critical part of making this
14 connection is by having all employees understand that the success of the business
15 is directly linked to their personal compensation. Nothing makes this link more
16 effectively than tying part of an employee's paycheck to the goals that the
17 business has set out for itself. Our employees take great pride in accomplishing
18 the goals our Company commits to achieve. The Company's at-risk compensation
19 program is a key part of how we have created and sustained this commitment to
20 accomplishing goals.

1 **Q. WHAT POSITION DO YOU UNDERSTAND THE COMMISSION TO**
2 **HAVE TAKEN IN PAST ORDERS RELATED TO AT-RISK**
3 **COMPENSATION?**

4 A. My understanding is that the Commission has recognized that at-risk
5 compensation can be a valid element of utility expense. In its most recent SCE&G
6 electric order, the Commission recognized 50% of SCE&G's at-risk compensation
7 in rates but did not allow in rates the 50% of other compensation related to
8 earnings targets. In that regard, the Commission stated the following:

9 as we noted in Order 1993-465, 'in the proper circumstances,
10 earnings levels and levels of investor returns can be valid
11 measures of a utility's ability to operate efficiently within the
12 revenues authorized by this Commission and of its success in
13 offsetting cost increases with increases in efficiencies.'" (Order No. 1993-465 at 12.). We encourage the Company to
14 develop incentive goals to encourage the Company to operate
15 more efficiently within existing revenues as well as increase
16 its profitability.

17
18
19 Order No. 2005-2 at p. 36.
20

21 **Q. WHY ARE EARNINGS GOALS A VALID AND IMPORTANT PART OF**
22 **SCE&G's AT-RISK COMPENSATION PLANS?**

23 A. Earnings goals are a valid and important part of SCE&G's at-risk compensation
24 plans for several reasons. First, earnings are the highest level indication of
25 whether the company has performed efficiently during a given period. For a
26 company to meet its earnings goals means that considering all factors related to
27 the business, it has operated efficiently enough to pay all costs of operations, to
28 pay its taxes, to pay debt service on its borrowings, and have produced a

1 reasonable return for its equity investors. No other indicator measures the overall
2 value the company has produced for all parties as clearly or as comprehensively as
3 earnings.

4 Furthermore, earnings uniquely link all aspects of the company together.
5 While personal and departmental goals are important, they must be balanced with
6 the efficiency and success of the company as a whole. That is why the Company's
7 plan balances departmental or business unit goals with overall earnings goals.

8 Finally, earnings are a simple, understandable, and thoroughly audited set
9 of numbers that employees see publicly reported and that they know to be
10 credible. To be effective, company-wide goals must be comprehensible and
11 credible to a broad range of employees, from hourly employees to financial
12 analysts. Earnings are uniquely suited to this role because of their simplicity, and
13 the fact that they are carefully scrutinized and publicly reported. Earnings are real
14 to employees in a way that other, less widely reported and less well understood
15 goals might not be.

16 It is not by accident that earnings play an important part in most
17 companies' incentive plans. In fact, over the course of my career in Human
18 Resources I have become familiar with the incentive plans of numerous companies
19 both within and outside of the utility industry. I am also familiar generally with the
20 thinking in the HR sector about how such plans should be devised. In almost all
21 cases, earnings are considered to be a key part of standard incentive plans today.
22 There is a clear consensus in business that earnings are a uniquely valuable means

1 to focus employees on the overall efficiency and productivity of the companies for
2 which they work.

3 **Q. HOW DOES SCE&G'S AT-RISK COMPENSATION COMPARE TO**
4 **THAT OFFERED IN THE MARKET?**

5 A. I have reviewed the at-risk compensation plans of many of the major investor-
6 owned utilities operating in the Southeastern United States. SCE&G's at-risk
7 compensation plans are structured in a similar way to those provided by many
8 other utilities in the region. The same can be said comparing SCE&G's incentive
9 plans to those of other companies of similar size and technical nature in the region
10 and nation. If anything, SCE&G's at-risk compensation is at or below the market
11 for such plans.

12 **Q. WHAT IS YOUR CONCLUSION CONCERNING THE EARNINGS**
13 **BASED COMPONENTS OF THE AT-RISK COMPENSATION PLAN**
14 **BEFORE THIS COMMISSION?**

15 A. It is my opinion that these are valid and necessary compensation expenses and
16 should be recognized as a part of SCE&G's costs of providing utility service.

17 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

18 A. Yes, it does.